IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF PENNSYLVANIA

In re:	)	Chapter 11
	)	
400 WALNUT ASSOCIATES, L.P.	)	Case No. 10-16094 (SR)
	)	
Debtor.	)	

REPLY OF 4TH WALNUT ASSOCIATES, L.P. TO MEMORANDUM OF LAW OF 400 WALNUT ASSOCIATES, L.P. IN SUPPORT OF ITS POSITION THAT IT HAS AN INTEREST IN THE RENTS FROM THE PROPERTY AND THAT THE RENTS FROM THE PROPERTY CONSTITUTE CASH COLLATERAL

4th Walnut Associates, L.P. ("4th Walnut"), by and through its undersigned counsel, files this reply (the "Reply") to the Memorandum of Law of 400 Walnut Associates, L.P. in Support of its Position that it has an Interest in the Rents from the Property and that the Rents from the Property Constitute Cash Collateral (the "Debtor Memo") [Docket No. 170] , and in support hereof respectfully represents as follows:[1]

The Debtor fails to acknowledge that the Alleged Agreement is subject to the Statute of Frauds

The Debtor argues that the Alleged Agreement is enforceable despite the fact that it was never memorialized by the parties. As a general observation, 4th Walnut does not disagree with the Debtor's summary of Pennsylvania state law regarding the enforcement of agreements not yet reduced to writing. However, the analysis is wholly inapplicable to the instant facts. As explained at length in the 4th Walnut Memo, the Alleged Agreement is a purported agreement not to pursue the real estate collateral securing the Loan, and,

[1] 4th Walnut hereby incorporates 4th Walnut Associates, L.P.'s Memorandum of Law (A) In Opposition to the Debtor's Motion for an Order (I) Pursuant to 11 U.S.C. § 363(c) and Fed.R.Bankr.P. 4001 Authorizing the Debtor to Use Cash Collateral and Provide Adequate Protection and (II) Granting Other Related Relief; and (B) In Support of 4th Walnut Associates, L.P.'s Cross Motion to Prohibit Use of Rents, to Compel Debtor to Segregate Rents and for an Accounting (the "4th Walnut Memo") [D.I. No. 169] as though set forth at length herein. Any capitalized terms not otherwise defined shall have the meaning ascribed to them in the 4th Walnut Memo.

therefore, is subject to the Statute of Frauds. *See* Section B.2., 4th Walnut Memo, pp.'s 16-22. Interestingly, none of the main cases relied upon by the Debtor in its argument involve real estate, much less real estate securing a loan. Rather, the contracts in question in those cases involved settlement of securities violations,[2] personal injury litigation,[3] negligence,[4] legal malpractice,[5] deprivation of interests[6] and payment of commission.[7] The exception is *Schermer v. Wilmart*, 282 Pa. 55, 127 A. 315 (1925), the single case cited to by the Debtor that does involve a real estate transaction in which the court ordered specific performance of a contract for the sale of real property where only a receipt existed, but the parties agreed to reduce the entire terms of the agreement to writing at a later date. In so doing, the court specifically held that it could only direct specific performance if "everything required by the statute of frauds appears in the written evidence of the contract." In that case, the receipt listed the party names, the sale price and description of the property, the amount of the deposit, the date of the next scheduled payment and the date of final settlement and transfer of the property. In light of the information contained in the receipt, the court held that the statue of frauds was satisfied. *Id.* at 58. The Debtors have not provided evidence of any writing memorializing the Alleged Agreements, much less one that contains material provisions thereof, because none exists.

It is also worth noting that, in most of the cases cited by the Debtor, the parties do not dispute that there was at least an oral agreement in theory between the parties. In the present case, in direct contradiction, 4th Walnut denies there was anything more than (at best) negotiations regarding a possible oral forbearance agreement between the Debtor and Sovereign that never came to fruition. In fact, on June 17, 2010, counsel to Sovereign Bank sent the Debtor a letter making clear that Sovereign "has opted to not pursue further discussions with [the Debtor] concerning the possibility of a forbearance of the Bank's remedies."[8] Regardless, the Statute of Frauds makes it clear that any alleged oral forbearance claimed by the Debtor must be in writing to be effective. As the Debtor has not and cannot provide any evidence of such writing, the Alleged Agreement is entirely unenforceable.

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[2] *Green v. John H. Lewis & Co.*, 436 F.2d 389 ((3d Cir. 1970)
[3] *Good v. Pennsylvania Railroad Co.*, 384 F. 2d 989 (3d Cir. 1967)
[4] *Mastroni-Mucker v. Allstate Ins. Co.*, 976 A. 2d 510, 2009 PA Super 101 (Pa. Super.Ct. May 29, 2009)
[5] *Muhammad v. Strassburger*, 526 Pa. 541 (1991)
[6] *Kazanjian v. New England Petroleum Corp.*, 332 Pa. Super 1 (1984)
[7] *Ketchum v. Conneaut Lake Co.*, 163 A. 534, 309 Pa. 224 (1932)

While there are certain narrow exceptions that remove writings from the requirements of the Statute of Frauds, as explained in the 4th Walnut Memo, none apply to the current facts.

4th Walnut respectfully submits that the failure of the Debtor to overcome the initial obstacle to provide evidence of a written document renders the remainder of the Debtor's arguments moot; however, they are specifically addressed below.

The Debtor had no interest in the Rents as of the Petition Date, as 4th Walnut was in constructive possession of the Property

The Debtor argues that 4th Walnut was not in possession of the Property prior to the Petition Date and, therefore, the Debtor retained a property interest in the Rents as of the Petition Date. While the Debtor does not deny the existence of the Foreclosure Action or the numerous Rent Demands issues by both Sovereign and 4th Walnut, it again mistakenly relies on the Alleged Agreement as a binding forbearance agreement that

[8] *See* Exhibit L-10 introduced into evidence by 4th Walnut at the December 9, 2010 hearing before this Court.

somehow negates the effect of the otherwise effective Transfers under the Mortgage. *See* 4th Walnut Memo, pp.'s 2-5 and 9-14.

To be clear, under the terms of the SNDA, the exercise by 4th Walnut's predecessor-in-interest, Sovereign, of the Assignment of Rents in November 2009, the commencement by Sovereign of a mortgage foreclosure action on January 29, 2010, and/or Rent Exercise by 4th Walnut of the Assignment of Rents (among other things) pursuant to the 4th Walnut Demand Notice and/or the Greentree Demand Notice—none of which are denied by the Debtor-- each constitutes a Transfer. By the occurrence of such Transfers, the Master Lease was, as of November 2009, or, if not then, by January 29, 2010, or, if not then, at the latest, as of the date of 4th Walnut's Demand Notice, considered to be a direct lease between 4th Walnut and Greentree, divesting the Debtor of any interest in the Master Lease and in any Rents generated by the Property. The fact that Sovereign and the Debtor sent jointly signed letters to the subtenants authorizing the Debtor to continue to collect Rents after the Foreclosure Action was filed was not an indication of a forbearance of the Foreclosure Action as the Debtor would like this Court to believe. Rather, the purpose of the letters was to "allay the confusion" that was a result of the Debtor sending incorrect information to the subtenants. The Debtor can point to no specific admission by Sovereign that there was any other intention in sending the letters, much less that they are proof of the Alleged Agreement.

The Debtor, in addition to arguing that it was not in default on the Loan Documents, also seems to argue that there is no "continuing default" under the Loan Documents and, therefore, that the Debtor is entitled to receive all residual rents after payments to 4th Walnut free and clear of the liens. 4th Walnut strongly disagrees. To the contrary, the original default as acknowledged by the Debtor[9] was and is continuing through the date of this filing.

The language in the Mortgage is not ambiguous

Interestingly, at no time prior to filing the Debtor Memo did the Debtor challenge the validity or clarity of the Assignment of Rents clause in the Mortgage. In fact, the Debtor, in its request for authorization to use cash collateral,[10] referred to the Assignment of Rents as "evidencing the obligations to [4th Walnut],"[11] an assertion which the Debtor repeats in Paragraph 21(b) of the Certification of John Turchi in Support of First Day Motions [D.I. No. 8]. Perhaps most telling is that the Debtor specifically directed the court to consider the issue in its Response to the Cross Motion: "Against this statutory backdrop, it is important to note for purposes of this Response that the Debtor at no time has disputed the validity of the Mortgage encumbering the Property under scrutiny. *At the same time, it is important to also note that the Debtor at no time has questioned the validity of the assignment of Rents produced by said Property*." *See* ¶ 37 of the Response of the Debtor to the Objection and Cross-Motion of 4th Walnut Associates, L.P. (the "Objection to Cross Motion" filed October 15, 2010 at D.I. No. 90) (emphasis added). In fact, in its twelve pages of argument dedicated to the issue of whether the Rents qualify as cash collateral in the Objection to Cross Motion, the Debtor doesn't once question the validity of the Assignment of Rents; rather, as has become clear over the course of these proceedings, the Debtor relied entirely on its inaccurate argument that 4th Walnut never asserted possession over the Rents pre-petition. In addition, all of the cases that the Debtor relies upon in its Objection to Cross Motion involve valid assignment of rents clauses. Finally, although the Debtor makes reference to the Assignment of Rents in both its Amended Plan and Amended Disclosure Statement [D.I. No.'s 139 and 140, respectively], nowhere in either does it challenge the effectiveness of the Assignment of Rents.

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[9] "Nevertheless, on or about November 9, 2009, Sovereign Bank declared a default under the Sovereign Loan." *See* Debtor Memo, p. 6.

[10] *See* Debtor's Motion for an Order (I) Pursuant to 11 U.S.C. § 363(c) and Fed.R.Bankr.P. 4001, Authorizing Debtor to use Cash Collateral and Provide Adequate Protection and (II) Granting Other Related Relief filed July 23, 2010 (the "Cash Collateral Motion") [D.I. No. 5].

[11] *Id.* at ¶17(b).

The Debtor's reliance on the case of *In re Vill. Green I, GP*[12] out of the Western District of Tennessee is not controlling here, not only because it was decided in the 6th Circuit but because it relies, in part, on Tennessee state law. More persuasive is the Third Circuit case of *In re Jason Realty, L.P.*, 59 F. 3d 423 (3d Cir. 1995), a case previously relied upon by the Debtor in papers filed with this Court.[13] The Third Circuit in *Jason Realty* held that the assignment of rents clause passed title to the lender and that the language of the assignment of rents supported an absolute assignment. Although *Jason Realty* was decided applying New Jersey law, its reasoning can be extended to the present case, as both New Jersey and Pennsylvania are "title theory" jurisdictions.[14]

The Third Circuit in *Jason Realty* held that language indicating that the debtor "hereby grants, transfers and assigns to the assignee the entire lessor's interest in and to those certain leases…together with all rents" was "quintessentially absolute, because it was a total assignment in *per verba de praesenti*…" *In re Jason Realty*, at 427 (emphasis

[12] 435 B.R. 525 (Bankr. W.D. Tenn. 2010).
[13] *See, e.g.*, Response and Affirmative Defenses of the Debtor to the Motion for Relief From the Automatic Stay filed August 20, 2010 [D.I. No. 49]; Response of the Debtor to the Objection and Cross-Motion of 4th Walnut Associates, L.P. filed October 15, 2010 [D.I. No. 90]
[14] In fact, the Bankruptcy Court for the Western District of Pennsylvania did just that, in *In re Robin Associates*, 275 B.R. 218 (Bankr. W.D. Pa. 2001), "mandate[ing] a result similar to that which New Jersey law dictated in *Jason Realty* with respect to an assignment of rents via a separate document…" *Id.* at 221.

provided). Furthermore, the Court held that "*[t]his exchange inescapably and unambiguously expressed an agreement to assign present title.*" *Id.* (emphasis added).

The Mortgage in the instant case provides even stronger language indicating the parties' intentions to make the assignment absolute:

3. Assignment of Rents; Appointment of Receiver; Lender in Possession.

> (a) As part of the consideration for the Indebtedness, Borrower absolutely and *unconditionally assigns and transfers to Lender all Rents*. It is the intention of Borrower to establish a present, absolute and irrevocable transfer and assignment to Lender of all Rents and to authorize and empower Lender to collect and receive all Rents without the necessity of further action on the party of Borrower…Borrower and Lender intend this assignment of Rents to be immediately effective and to constitute and absolute present assignment and not an assignment for additional security only…

Section 3 (a), Multifamily Mortgage, Assignment of Rents and Security Agreement (emphasis added). In fact, the Assignment of Rents clause is replete with references to the parties' intentions.

The Debtor argues that the inclusion of "all Rents and Leases" in the definition of "Mortgaged Property" is in direct contradiction with Paragraph (a) of the Assignment of Rents clause of the Mortgage, which, for the purposes of the assignment only, removes Rents from the definition of Mortgaged Property ("…[f]or purposes of giving effect to this absolute assignment of Rents, ***and for no other purpose***, Rents shall not be deemed to be a part of the 'Mortgaged Property'…" *Id.* at p. 7. The Debtor argues that the two provisions "cannot be reconciled together" when, as is made clear by the language, excluding the Rents from the definition of Mortgaged Property is an *exception* to the general premise that Rents are included as Mortgaged Property. There is no ambiguity created. The Rents are still considered as part of the Mortgaged Property under all other sections of the Mortgage.

Advisors and counsel to the Debtor who entered into this Mortgage, including the Assignment of Rents clause, are savvy business persons, well versed and experienced in negotiating and drafting such documents. For the Debtor to now, for the first time during these entire proceedings, challenge the efficacy of the Assignment of Rents clause appears as a last ditch effort to no longer be bound by language it originally freely and knowingly agreed to.

Plan and Disclosure Statement

While not directly relevant to the issues at hand, the Debtor in the Debtor Memo discusses the Plan and Disclosure Statement and amendments filed thereto. 4th Walnut will therefore briefly address the Debtor's assertions with respect thereto.

On October 21, 2010, the Debtor filed its Chapter 11 Plan of Reorganization (the "Plan") [D.I. No. 98], Disclosure Statement [D.I. No. 99] and Motion to Approve Disclosure Statement (the "DS Motion") [D.I. No. 100]. On November 29, 2010, 4th Walnut filed an objection to approval of the Disclosure Statement (the "DS Objection") [D.I. No. 135] in which it raised an objection to the fact that, *inter alia*, the Debtor failed to provide any information in support of its assertion that there was a forbearance in place. *See* DS Objection, ¶ 18. RAIT Partnership, L.P. filed a Statement and Reservation of Rights with respect to the DS Motion and Sunlight Electrical Contracting Co. Inc. filed an Objection. At the December 9, 2010 hearing before this Court, the Debtor represented that it cured the objections that were raised by the objecting parties. *See*

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Hearing Tr., 16:21-17-6. However, the Amended Disclosure Statement similarly fails to provide any evidence of the Alleged Agreement.

In its Memo, the Debtor makes the unsupported statement that "the pre-petition default under the Sovereign Loan will be cured and the Sovereign Loan reinstated." *See* Debtor Memo, p. 14. The Memo goes on to make additional unsupported statements in support of the Plan. It is interesting that while the Debtor on the one hand argues that the default has no effect (and is not continuing) as a result of the Alleged Agreement, on the other hand it states that the default will be cured and the Sovereign Loan reinstated under the Plan.

4th Walnut hereby reserves all rights to argue its DS Objection as well as make objections to confirmation of the Plan at the appropriate time and in the appropriate format.

Post-Petition Rents

With respect to the Debtor's rights to utilize rents arising from leases entered into post-petition, 4th Walnut reserves all rights to challenge the classification of post-petition leases as "new" leases as opposed to "renewed" leases.

CONCLUSION

As stated in the 4th Walnut Memo, the Debtor's rights in the Rents were cut off well before the Petition Date. The Debtor provided no evidence whatsoever in the Debtor Memo that contradict that fact. Rather, it continues to rely on the false and unsubstantiated assumption that the parties were acting in reliance on an alleged forbearance agreement. Consequently, the Debtor should not be permitted to use the Rents.

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